Report of the auditor-general to the Gauteng Provincial Legislature and the council on the Merafong City Local Municipality

Report on the audit of the financial statements

Opinion

1. I have audited the financial statements of the Merafong City Local Municipality set out on pages ... to ..., which comprise, the appropriation statement, the statement of financial position as at 30 June 2017 and the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the financial statements, including a summary of significant accounting policies.
2. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Merafong City Local Municipality as at 30 June 2017, and its financial performance and cash flows for the year then ended in accordance with South African Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2016 (Act No. 3 of 2016) (DORA).

Basis for opinion

3. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the financial statements section of my report.
4. I am independent of the municipality in accordance with the International Ethics Standards Board for Accountants' *Code of ethics* for *professional accountants* (IESBA code) together with the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA code.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Material uncertainty related to going concern

6. As disclosed in note 45 in the financial statements, the municipality incurred a net loss of R86 049 954 during the year ended 30 June 2017 and, as of that date the municipality's current liabilities exceeded its current assets by R173 650 707. As stated in note 45, these events or conditions, along with other matters as set forth in note 39, indicate that a material uncertainty exists that may cast significant doubt on the municipality's ability to continue as a going concern. My opinion is not modified in respect of this matter.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

8. As disclosed in note 42 to the financial statements, the corresponding figures for 30 June 2016 have been restated as a result of errors discovered in the financial statements of Merafong City Local Municipality for the year ended 30 June 2017.

Material impairments

9. As disclosed in note 12 to the financial statements, the consumer debtors balance has been significantly impaired. The allowance for impairment of consumer debtors amounts to R940 805 837 (2015-16: R719 141 682) which represents 82.6% (2015-16: 79.2%) of total consumer debtors. The contribution to the provision for debt impairment was R263 761 962 (2015-16: R203 893 117).

Material losses

10. As disclosed in note 53 to the financial statements, material water losses amounting to R42 485 098 (2015-16: R46 738 845) were incurred, which represents 43.32% (2015-16: 47.69%) of the total water purchased. Technical losses amounted to R33 332 034 (2015-16: R36 669 347). Non-technical losses amounted to R9 153 063 (2015-16: R10 069 498) and are mainly due to deterioration of the water reticulation system, burst pipes and unauthorised consumption.

11. As disclosed in note 53 to the financial statements, material electricity losses amounting to R60 778 294 (2015-16: R58 765 650) were incurred, which represent 24.81% (2015-16: 29.44%) of total electricity purchased. Technical losses amounted to R51 431 557 (2015-16: R49 728 426). Non-technical losses amounted to R9 346 736 (2015-16: R9 037 224) and are due to unauthorised consumption, tampering and faulty meters.

Material uncertainties

12. With reference to note 39 to the financial statements, the municipality is the defendant in various lawsuits. The outcome of these matters cannot presently be determined, and/or reliably measured, therefore no provision for any liabilities that may result has been made in the financial statements.

Other matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA in the financial statements. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Responsibilities of the accounting officer for the financial statements

15. The accounting officer is responsible for the preparation and fair presentation of the financial statements in accordance with SA Standards of GRAP and the requirements of the MFMA and the DoRA and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

16. In preparing the financial statements, the accounting officer is responsible for assessing the Merafong City Local Municipality's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless there is an intention either to liquidate the municipality or to cease operations, or there is no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the financial statements

17. My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

18. A further description of my responsibilities for the audit of the financial statements is included in the annexure to the auditor's report.

Report on the audit of the annual performance report

Introduction and scope

19. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof I have a responsibility to report material findings on the reported performance information against predetermined objectives for selected goals presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

20. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.

21. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected goals presented in the annual performance report of the municipality for the year ended 30 June 2017:

Goals	**Pages in the annual performance report**
Goal 1: Basic services	x – x
Goal 5: Good governance and public participation	x – x
Goal 6: To provide an integrated spatial development framework	x – x

22. I performed procedures to determine whether the reported performance information was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

23. I did not identify any material findings on the usefulness and reliability of the reported performance information for the following goals:

- Goal 1: To provide basic services
- Goal 5: To provide good governance and public participation
- Goal 6: To provide an integrated spatial development framework

Other matters

24. I draw attention to the matters below.

Achievement of planned targets

25. Refer to the annual performance report on pages XX to XX for information on the achievement of the planned targets for the year and explanations provided for the underachievement of a number of targets.

Adjustment of material misstatements

26. I identified material misstatements in the annual performance report submitted for auditing. These misstatements were on the reported performance information of Goal 1: To provide basic services, Goal 5: To provide good governance and public participation and Goal 6: To provide an Integrated spatial development framework. As management subsequently corrected the misstatements I did not raise any material findings on the usefulness and reliability of the reported performance information

Report on the audit of compliance with legislation

Introduction and scope

27. In accordance with the PAA and the general notice issued in terms thereof I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

28. The material findings on compliance with specific matters in key legislation are as follows:

Expenditure management

29. Money owed by the municipality was not always paid within 30 days as required by section by section 65(2)(e) of the MFMA.

30. Effective steps were not taken to prevent irregular expenditure amounting to R29 158 270 as disclosed in note 48 to the annual financial statements, as required by section 62(1)(d) of the MFMA. All of the irregular expenditure was caused by contravention of section 19(a) and section 36(1) of the supply chain management regulations.

31. Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R16 371 945, as disclosed in note 47 to the annual financial statements, in contravention of section 62(1)(d) of the MFMA. All of the disclosed fruitless and wasteful expenditure was penalties and interest incurred due to late payments made to suppliers.

Consequence management

32. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the MFMA.

Procurement and contract management

33. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by Municipal Supply Chain Management Regulation (SCM regulation) 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

34. Awards were made to providers who were in the service of other state institutions or whose directors were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44.

Strategic planning

35. The SDBIP was revised during the year without approval of the council as required by section 54(1)(c) of the MFMA.

Other information

36. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected goals presented in the annual performance report that have been specifically reported on in the auditor's report.

37. My opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

38. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected goals presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated. I have nothing to report in this regard.

Internal control deficiencies

39. I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance thereon. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on compliance with legislation included in this report.

Leadership

40. The accounting officer did not exercise adequate oversight responsibility regarding performance reporting and compliance with applicable laws and regulations. This resulted in adjustments to the annual performance report. Action plans to address prior

year audit findings were not in all instances adequately monitored which resulted in a number of repeat findings on non-compliance with MFMA and SCM regulations.

Financial and performance management

41. Senior management did not adequately monitor controls in place to ensure that performance reports are supported by complete, relevant and accurate information, and that compliance with laws and regulations are adhered to.

Other reports

42. I draw attention to the following engagement conducted by an external party that had, or could have, an impact on the matters reported in the municipality's financial statements, reported performance information, compliance with applicable legislation and other related matters. This report did not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

Investigation

43. There is currently an investigation in progress that are being conducted by an independent consultant. This investigation was initiated based on allegations of possible irregularities in relation to SCM regulations and human resource management. This investigation was still in progress at the reporting date.

Auditor - General

Johannesburg

30 November 2017

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure A – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for selected goals and on the municipality's compliance with respect to the selected subject matters.

Financial statements

2. In addition to my responsibility for the audit of the financial statements as described in the auditor's report, I also:

   - identify and assess the risks of material misstatement of the financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

   - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control.

   - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by accounting officer.

   - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Merafong City Local Municipality ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the financial statements. My conclusions are based on the information available to me at the date of the auditor's report. However, future events or conditions may cause a municipality to cease to continue as a going concern.

   - evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and where applicable, related safeguards.